



INTERNAL AUDIT CONTROLS EVALUATION ACCOUNTS PAYABLE

June 2, 2003

Roanoke City Council Audit Committee
Roanoke, Virginia

We have completed an audit of the Accounts Payable process of the Department of Finance. Our audit was performed in accordance with generally accepted government auditing standards.

BACKGROUND

The Department of Finance is responsible for the processing and timely remittance of accounts payable for the City of Roanoke and Roanoke City School system. This function is primarily performed by the Accounts Payable staff which includes an Accounts Payable Supervisor, two Accounts Payable Clerks, and a Data Entry Clerk. Additional staff is utilized within the school system's Business Services department to assist in the processing of their accounts payable transactions.

There are three primary methods for processing City of Roanoke accounts payable: 1) on-line requisitions, 2) payment vouchers, and 3) purchasing cards. The on-line requisitions method requires departments to initiate the purchase request through the extended purchasing system (EPS) on their work station. The purchase order that is produced lists the requesting department as the address for delivery and the Department of Finance as the address for billing. When the purchase is received by the requesting department, the department enters the receiving information into the EPS. When Finance receives the invoice, the Accounts Payable staff inputs the invoice information into the accounting system and verifies through the EPS that the order was received and agrees to the purchase order and invoice. Accounts Payable releases the file of all matched invoices twice each week to print checks. Typically, transactions on bid related purchases and those involving recurring contractual payments utilize this method of processing.

The payment voucher method is typically used for transactions such as subscriptions, dues, utility bills, and other purchases that do not have a competitive bid component and are not conducive to the requisitioning process. Department Managers can submit payment vouchers for purchases up to \$25,000 without any additional approvals. The payment voucher must be accompanied by an original vendor invoice for Accounts Payable to process it. The Accounts Payable staff enters the payment voucher on the accounting system and the associated checks are produced during the normal check print routine.

The last method of payment processing involves the use of procurement cards issued to in the City's name through Wachovia Bank. These transactions involve the use of an approved credit card to pay for goods or services costing less than \$2,500. The user department is responsible for reconciling its purchase receipts to a spreadsheet listing the department's monthly purchase activity. The department is also responsible for ensuring purchases are charged to the proper line item expense account. Departments submit their monthly statement along with the original receipt for each purchase to the Department of Finance. The Accounts Payable staff files the statements and receipts in Finance and initiates a wire transfer reimbursing Wachovia for all purchases made with the purchasing card.

For the fiscal year ended June 30, 2002, the Accounts Payable staff processed vendor invoices for approximately 4,700 City purchase orders and 19,000 payment vouchers (13,000 City and 6,000 School). In addition, it also processed approximately 6,600 personal assistance checks and 1,300 personal property tax refund checks.

PURPOSE

The purpose of this audit was to evaluate the system of controls in place to ensure:

- Accurate and efficient processing of payments.
- Compliance with Administrative Procedures addressing accounts payable processing.

SCOPE

The audit evaluated controls, policies, and procedures in place as of September 1, 2002. Our test work primarily focused on data from January 1, 2002 to September 30, 2002. The audit did not address processes related to travel reimbursements, procurement card transactions, or Roanoke City Public School's accounts payable processing. In addition, this audit will not address compliance with the Virginia Prompt Payment Act, as this aspect was reviewed in a prior audit of this area.

METHODOLOGY

We gained an understanding of the processes in Accounts Payable through observation and interviews of employees in the department. We reviewed relevant internal source documents such as the Comprehensive Annual Financial Report, departmental Strategic Business Plan, and City Administrative Procedures. We then conducted analyses using accounting system transaction data to obtain targeted samples. We judgmentally selected transaction data for testing on a sample basis due to the volume of relevant data.

RESULTS

The Department of Finance's Accounts Payable staff has developed a number of procedures for controlling and monitoring the payment of vendors. Our test work

indicated that authorizations are substantially compliant with requirements as outlined in Administrative Procedure 3.5. We also determined that accounts payable transactions, including voids, are substantially supported by appropriate invoices and forms. Additional notations were present on many of the transactions to clarify the nature of the transaction and the parties involved, and cross-references were provided to properly identify reissued payments for voided transactions. We also noted that the Accounts Payable staff is involved in on-going process improvement projects that include the development of a “sealed” check printing process, payments by electronic funds transfer (EFT), and the preparation of a formal Accounts Payable Operations Manual. Over the course of the audit, we noted two areas where controls could be improved as described below. Less significant concerns were referred to management.

Finding 01 – Payment Vouchers

At the time of the audit, Administrative Procedures 3.4, 4.7, and 4.8 provided the only specific guidelines for the usage of payment vouchers. Our analysis showed that there are several areas for improvement in these procedures. Administrative Procedure 3.4 states that payment vouchers are to be used for “payment of non-bid items or services, such as dues, subscriptions, refunds, reimbursements, and utility bills”. Our analysis indicated that during the test period, over \$37,000,000 was spent using payment vouchers. Of this figure, over \$6,700,000 (18.13%) was spent on fees for professional services. Further analysis of this account showed that at least \$1,150,000 was spent with vendors in arrangements that were basically service contracts. Administrative Procedures 4.7 & 4.8 state that payments for service contracts, rental contracts, and equipment repairs should be processed using payment vouchers. However, the nature of the payment voucher allows for too little review and may result in abuse as identified in audits of other agencies. Furthermore, these guidelines do not prescribe methods of monitoring or reconciling the usage of payment vouchers as compared to other payment methods. Related analysis of payment vouchers indicated that 3 of 10 (30%) sample cancelled check transactions were cancelled due to duplicate payment of a vendor via payment voucher after a procurement card was charged for services.

Agreed Upon Actions 01 – Payment Vouchers

We have discussed this issue with the Deputy Director of Finance, Manager of Accounting Services, and the Accounts Payable Supervisor. We have agreed that the City’s Administrative Procedures will be revised to be more complimentary and consistent. Administrative Procedure 3.4 will be revised to specifically define and limit the usage of payment vouchers. In addition, the Department of Finance should develop a method for analyzing the usage of payment vouchers on an annual or semi-annual basis to identify areas of potential abuse. Since the time of the audit, new policies defined in the Procurement Manual have eliminated Administrative Procedures 4.7 and 4.8 dealing with payments of service and rental agreements in favor of a single Administrative Procedure 4.0.

Management Response 01 – Payment Vouchers

The Department of Finance has revised Administrative Procedure 3.4 to limit the use of payment vouchers to specific items effective July 1, 2003. This should eliminate the use of payment vouchers for professional services, as these transactions will be required to be processed on purchasing documents. The Accounts Payable staff will review payment vouchers as they are processed to insure compliance with the new procedure. Payment vouchers not in compliance with the procedure will be returned to the submitting department for processing on the correct document.

Finding 02 – Miscellaneous Vendors and Vendor Setup

The Department of Finance has created “Miscellaneous” vendor identification numbers that aid in limiting the number of vendor files that must be set up and facilitates more efficient processing of payables. Finance uses identification numbers such as 111111 as miscellaneous vendor identifiers so that they can be easily recognized. The miscellaneous vendor numbers are supposed to be used for vendors that are considered likely to be used only one time. We can expect that there will be many one time vendors such as individuals receiving a refund payment or someone receiving a payment from the city based on a claim for property damage. One drawback resulting from the use of miscellaneous vendors is the reduced transaction history by vendor accumulated on our accounting system. The accounting system is structured in such a way that it limits the ability to extract vendor specific information out of the miscellaneous vendor file. This reduces the ability of management to monitor payment history for individual vendors paid through the miscellaneous vendor accounts.

Using audit software to extract data from the 111111 vendor account, we determined that 60 of 589 (10.19%) transactions were for vendors who received a minimum of five separate payments as miscellaneous vendors. These vendors should have been assigned individual vendor identification numbers since they were used more than one time.

We also noted that 28% of the transactions in the 111111 vendor account were payments issued by the Department of Social Services for income maintenance and 26% were payments issued by Risk Management for claims. These payments are appropriate to process as miscellaneous vendors. However; segregating high volumes of related payments such as these into their own miscellaneous vendor accounts could provide an opportunity for better management oversight of those payments.

Agreed Upon Actions 02 – Miscellaneous Vendors and Vendor Setup

We have discussed this issue with the Deputy Director of Finance, Manager of Accounting Services, and Accounts Payable Supervisor. We have agreed that Finance should establish specific guidelines to define the nature and use of miscellaneous vendors. Furthermore, an analysis of transactions should be performed periodically to identify those departments with high volumes of miscellaneous vendor transactions and determine when a new vendor should be established. Once identified, additional

separate miscellaneous vendor categories should be set up for those departments. In the course of the discussion of vendor setup and maintenance, we agreed that a standard vendor request information form should be drafted to gather necessary setup and screening data. This form should be designed to gather 1099, demographic, and professional licensing data. In addition, we agreed to further enhance the control of vendor setup and maintenance, by requiring that vendor personnel complete and remit the form before payment is made to the vendor.

Management Response 02 – Miscellaneous Vendors and Vendor Setup

The Accounts Payable area is in the process of reviewing its guidelines for setting up new vendors. We plan to require a new vendor set-up form be completed and submitted by the vendor before a payment can be made. The new form will include required information to comply with Internal Revenue Service reporting, demographic information, and licensing compliance. The target implementation date for this form is January 1, 2004.

We also have met with Social Services regarding their use of miscellaneous vendors. We will have several new miscellaneous codes effective July 1, 2003 for Social Services to use. We will monitor miscellaneous vendor use by Risk Management and other departments and will create separate miscellaneous vendor codes when necessary.

CONCLUSION

Based on the results of the audit, we conclude that the system of internal controls in the Department of Finance provides reasonable assurance that accounts payable are processed accurately.

We would like to thank the management and staff of the Department of Finance's Accounts Payable Division for their cooperation and assistance during the course of this audit.

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